



Debates and Perspectives

# Country attractiveness for offshoring and offshore outsourcing: additional considerations

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## Abstract

In this article, we review aspects relating to the attractiveness of India for information technology offshore – outsourcing. Our starting point is that, indeed, India will remain competitive in the short-medium term. However, more importantly, we move on to argue that country attractiveness is becoming a less important issue. We consider an alternative approach to analyze country attractive in which the client's strategic intent behind going offshore and the vendor's global dispersedness and its local knowledge define the attractiveness of the firm's offshoring strategy.

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## Introduction

In this paper, we explore the attractiveness of India and other offshore locations for multinationals as a possibility to either offshore outsource or offshore their information technology (IT) services. We can start by stating that there is no doubt that India will remain a major attractive destination for offshore outsourcing and/or offshoring of IT services in the coming years. We do not challenge the observations made by Joshi and Mudigonda concerning the competitive position that India has established in this particular market. Clearly, India has developed a wide skills-base, which is still low cost, along with other aspects such as proficiency in English and the adoption as well as the improvement of Western management and software development methodologies (Oshri *et al.*, 2007b, 2008b). True, in the context of offshoring and offshore outsourcing, India also presents certain disadvantages such as poor infrastructure; however, multinationals have found a way to work around such hurdles. In general, however, the topic of country attractiveness is wide and diverse and there could certainly be more than one way to explore this topic.

While Joshi and Mudigonda suggest that any approach should be based on understanding the motivating, inhibiting and facilitating factors involved in the issue of country attractiveness, our approach starts with the firm, by simply posing the following question: what is the strategic intent

behind going offshore, and through what means is the firm intending to achieve this strategic intent? With such an approach we do not discard Joshi and Mudigonda's line of thinking; however, we suggest that first the firm should clarify its intentions prior to assessing the inhibiting, facilitating and motivating factors of a potential offshore location. In fact, we argue that once the firm has started by clarifying its strategic intent, pursuing a careful examination of the potential offshore location is then the most sensible exercise to follow. We now explain our approach by providing examples from our studies and where appropriate link our view with Joshi and Mudigonda's.

## Offshore outsourcing or offshoring: some considerations

When considering the attractiveness of a location for sourcing activities, one should also consider the arrangement through which such sourcing activities should be carried out in a particular location. Our study of offshore outsourcing and offshoring shows that firms should be made aware of the differences between these different arrangements regardless of the attractiveness of a particular potential destination. Firstly, there is evidence now that setting up a captive center is more expensive for a multinational than it is for a local vendor (Oshri *et al.*, 2008). Indeed, there is now ample evidence suggesting that

while companies have steadily increased the volume of work outsourced to service providers located offshore, a large number of firms have also set up captive centers in offshore locations and that the number of these centers is steadily growing. Among the Forbes 2000 companies, 44 had captives in India in 2000, 71 in 2003 and 110 in 2006, with about \$9 billion worth of IT and business process outsourcing activities shifted to captive centers in India in 2006 only. Most captives are set up for one of the following reasons: to reduce costs, to access skilled and qualified personnel or to expand and enter new markets (Carmel and Tjia, 2005).

Indeed, captive centers have delivered value through cost savings, increased productivity and quality as well as innovation. However, firms that have set up captive centers in India because of the attractiveness of this offshore location have not always been successful. Our study of the Fortune Global 150 shows that nearly 20% of the Fortune Global 150 with captive centers in India have either divested or terminated their operations following negative service experiences. Only a small number of firms that divested their captives have registered a profit on this transaction, while most of the firms had to bear significant losses (Oshri *et al.*, 2008). Another approach taken by some 16% of our sample was to outsource noncore activities from their captive centers to local vendors. The rationale for this was that the captive center sought to reduce costs and free up resources to work on high value-adding activities. However, our studies show that although the conditions were in favor of success, considering that both vendor and client were working in geographical proximity, in the same time zone and few if any cultural differences, such outsourcing arrangements have in fact encountered serious challenges. The key challenge was the loss of application knowledge over time by the vendor, which resulted in the client investing time having to respond to escalated service calls and because of retraining and additional knowledge transfer sessions.

Our analysis suggests that there are two main reasons why vendors and clients face such challenges, regardless of the attractiveness of the country. One is because clients in offshore locations, that is, captive centers, do not develop capabilities to properly manage such outsourcing relationships. Secondly, local vendors tend not to invest in such small-scale outsourcing projects in which the activities are often repetitive, resulting in high attrition and a dissatisfied workforce. Therefore, regardless of the attractiveness of the country, multinationals should consider two particular aspects: One is the strategic intent behind offshoring (i.e., setting up a captive center), and the second is the market conditions at the offshore location. Let us consider India and the IT market. This is a well-developed market, that is, populated with numerous innovative competitors and that enjoys also strong demand. Multinationals whose strategic intent is to lower costs by offshoring activities via a captive center should be aware that the setup costs for a multinational are higher than for a local vendor; therefore without building up scale, a multinational would be better-off offshore outsourcing work to a local vendor rather than setting up their own captive center. On the other hand, multinationals that seek to grow by setting up an IT development center in India, should be aware that local

vendors are more likely to outperform them when competing for local clients because of the local vendors' favorable cost structure. Therefore, such multinationals should seek to attract clients outside India to ensure growth and reduce the cost of unit work performed offshore.

What is the relevance of our discussion to the concept of country attractiveness presented by Joshi and Mudigonda? First, we submit that in the case of offshoring, multinationals should consider country attractiveness as presented by Joshi and Mudigonda as well as the strategic intent of the firm in setting up a captive, and also the market conditions at the offshore location. Failing to understand the challenges involved in setting up a captive and without a long-term strategic intent to either grow or achieve cost savings, multinationals will probably fail to gain from offshoring activities by solely relying on country attractiveness as the key factor for setting up a captive center. Furthermore, some multinationals have chosen to acquire a development center based on the favorable technical and market knowledge possessed by the development center, which did not necessarily reflect on the attractiveness of the entire country. Israeli start-ups acquired by multinationals are one example. Israel no longer presents a cost advantage in comparison to India, and the country presents medium to high risk for investment considering the ongoing instability of the Middle-East; however, many Israeli start-ups possess market and technical knowledge relevant to penetrating the United States market, which is rather attractive for multinationals.

When it comes to offshore outsourcing, we agree that the attractiveness of the country is a key factor that multinationals should consider. Indeed, vendors from India are in an excellent position to exploit their cost advantage and leverage their advanced skills-base to benefit their clients. Nonetheless, one should ask: what are clients, in particular large clients, looking for in a vendor?

#### **Local knowledge and global dispersedness**

Let us consider the \$1.2 billion outsourcing contract between ABN AMRO and five vendors, IBM, Tata Consultancy Services (TCS), Infosys, Patni and Accenture, to outsource the bank's IT infrastructure, and its maintenance and future development. We have learned from discussions with ABN AMRO executives that one critical aspect in this outsourcing contract was to work with vendors who can deliver and leverage value across the globe. True, the offshoring component was also important to ABN AMRO in order to achieve cost savings; however, it was no less important to work with a vendor such as TCS who could provide support in Luxemburg, Amsterdam, Sao Paolo and other locations through a network of global delivery centers. Clearly, with increasing globalization and with the majority of large multinational enterprises (MNEs) having a presence in many countries, such capabilities of vendors are important. Primarily, MNEs are looking for vendors who are able to leverage value and provide support across the globe, while considering the cost savings of the vendor's home country as second to their vendor selection process. MNEs also value a vendor's ability to understand and act upon local knowledge while providing global



support. Such capability depends to a lesser extent on the home country of the vendor and to a larger extent on its dispersedness, the diversity of its workforce and other traits. In this regard, it appears that some IT vendors have indeed recognized the importance of developing local knowledge while standardizing software development processes across various sites. We have studied TCS's distributed expertise system, which in our opinion is critical to TCS's ability to leverage value across the globe (Oshri *et al.*, 2007b; Kotlarsky *et al.*, 2008). In this regard, we align our argument with Joshi and Mudigonda, and further claim that TCS can support global clients because of its offshore facilities, which enjoy highly skilled engineers who performed critical work in capturing local knowledge, screening and refining local best practices and making local best practices available to its global workforce. Indeed, Indian companies such as TCS and Infosys have become attractive to MNEs because of the combination of global dispersedness and the sophisticated application of highly skilled engineers to add value to global operations.

Having argued so, there is a case that should be made for small-medium size enterprises (SMEs) as well. Despite the attractiveness of India for offshore outsourcing, because of their small-scale outsourcing projects, SMEs do not tend to be attractive clients for the large Indian IT vendors. Indeed, there is growing evidence that SMEs tend to nearshore their activities and therefore prefer proximity over cost advantage and skills. In this regard, culture still plays a major role in offshoring and offshore outsourcing.

### Cultural differences in offshore outsourcing

Our studies relating to cultural differences between clients, onshore and offshore teams suggest that cultural differences between members of project teams can result in miscommunications and misperceptions that can overshadow many of the advantages of the offshore location (Kotlarsky and Oshri, 2005; Oshri *et al.*, 2007a, 2008a). This can be the case for client-vendor teams but also for onsite-offshore vendor teams. Indeed, Joshi and Mudigonda have mentioned culture aspects as part of the human resource advantages of India, focusing on proficiency in English as a key aspect of culture; however, we believe this aspect deserves far more attention. Evidence we collected at Baan concerning their inability to codevelop reusable components using teams located in the Netherlands and India was attributed to cultural differences (Oshri *et al.*, 2007a). On the other hand, SAP was successful in developing reusable components because of its investment in continuously renewing social ties between the German and Indian teams throughout the development project (Oshri *et al.*, 2007a). Socializing, norming and renorming offshore and onsite teams in order to renew social ties, renegotiate the meaning of communication protocols and development methodologies, and eventually rebuild the global team, were some of observations we have made in these studies.

But there are some Indian cultural attributes we have come across that deterred firms from capitalizing on the country's relative advantage. For example, Lizatec, a Dutch firm owned by a woman decided not to set up a captive in

India because of what perceived to be a different perception by Indians concerning the role of women in society. From interviews we conducted at the Dutch firm we learned that while India was perceived as the most attractive location to set up a development center, the visits of the Dutch management team gave them the impression that local male programmers would struggle to work under the supervision of a female executive (Kotlarsky and Oshri, 2005). The Dutch firm eventually decided to set up a development center in Russia instead.

There are other cultural attributes that Joshi and Mudigonda could have considered as part of human resource advantage that makes India and the Indians attractive for offshoring and offshore outsourcing, such as flexibility in working hours, willingness to share knowledge, modesty and friendliness. Such cultural attributes are particularly important for relationship capabilities that Indian vendors have successfully developed.

### Conclusion

In this paper we have explored an alternative, although complementary, approach to exploring the attractiveness of India as an offshore destination for IT services. We conclude that, in addition to the observations made by Joshi and Mudigonda, there is room to consider the strategic intent of the firm, which can be based either on a growth or cost advantage, prior to assessing the attractiveness of the destination country. Furthermore, we also make a distinction between offshoring through a captive center and offshore outsourcing, and explain the implications of this for the country attractiveness in general and for India in particular. We discuss the importance of global dispersedness as an advantage to leverage value across the globe regardless of the home country, and lastly highlight the impact that cultural differences may have on the advantages that India may have to offer to IT services in the future.

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